Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Machado, et al.	Analyst:	Scott McFarlane	Bill Number:	SB 1055
Related Bills:	See Prior Analysis	Telephone:	845-6075	Amended Date:	April 22, 2008
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Mortgage Forgiveness Debt Relief

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ___________________.

_X_ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ____________________.

_X_ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED February 25, 2008, STILL APPLIES.

____ OTHER – See comments below.

SUMMARY

This bill would generally conform California law to the recently-enacted federal Mortgage Forgiveness Debt Relief Act of 2007, which generally provides for an exclusion from gross income for qualified debt forgiveness on a principal residence, up to a maximum amount.

SUMMARY OF AMENDMENTS

The April 22, 2008, amendments added additional coauthors and provide that no interest or penalties shall be assessed on cancellation of debt (COD) income that results from the discharge of qualified residence indebtedness during the 2007 taxable year. As a result of the amendments, the This Bill, State Law, and Economic Impact discussions included in the analysis of the bill as amended February 25, 2008, have been revised. In addition, an Implementation Consideration has been identified and is included below. Except for the discussion in this analysis, the remainder of the department's analysis of the bill as amended February 25, 2008, still applies.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	5/9/08
____ N	____ OUA	_X_ PENDING		

ANALYSIS

STATE LAW

Estimated Tax

Individuals are generally required to pay their estimated California income tax in four installments spread over the taxable year. For example, 2007 calendar-year taxpayers were required to pay 25% of their estimated tax by April 15, 2007; the next 25% by June 15, 2007; the next 25% by September 15, 2007, with the final 25% due by January 15, 2008. Any withholding is treated as a payment of estimated tax, and the total withholding for the year is generally considered as having been paid in four equal installments.

There are special rules for farmers and fishermen, and for taxpayers whose income fluctuates significantly from one installment period to the next.

Penalty for Underpayment of Estimated Tax

A penalty is imposed for the underpayment of estimated tax. The penalty is generally computed by multiplying three factors: (1) the underpayment; (2) the interest rate;[1] and (3) the number of days each installment is underpaid.

The amount of the underpayment for the taxable year is the difference between the amount of tax <u>shown on the return</u> for the taxable year and the amount of estimated tax paid. Generally, the amount of tax shown on the return for the taxable year is divided by four, and this is the amount of estimated tax due in each of the four installments. Thus, the amount of the underpayment for each installment is the estimated tax due for that quarter less the amount actually paid.

There are exceptions to the penalty, and if any are met, the penalty does not apply. Exceptions include the following:

1. If the tax liability is less than $200;
2. If there was no tax liability in the prior taxable year; and
3. If total withholding plus estimated tax payments total 90% of the tax shown on the current year return or 100% of the tax shown on the prior year's return.

[1] California conforms to the federal interest rate, which is provided in Internal Revenue Code section 6621.

THIS BILL

In General

This bill would conform to the mortgage-debt forgiveness provision of the federal Mortgage Forgiveness Debt Relief Act of 2007, with two differences: (1) the exclusion period, and (2) the maximum exclusion amount.

The difference in the exclusion *period* is:

- *Federal* - The exclusion applies to discharges occurring on or after January 1, 2007, and before January 1, 2010.
- *California* – This bill would exclude discharges occurring on or after January 1, 2007, and before January 1, 2009.

The difference in the maximum exclusion *amount* is:

- *Federal* - The maximum exclusion is $2,000,000.
- *California* – The maximum exclusion is $1,000,000.

Penalty and Interest Waiver

COD income from the discharge of qualified principal indebtedness is currently required to be included in income for California purposes; therefore, any taxpayer who filed a 2007 personal income tax return on or before April 15, 2008, was required to include any COD income that this bill would exclude. Because the underpayment of estimated tax penalty is based on the "amount of tax shown on the return," taxpayers who filed a 2007 personal income tax return on or before April 15, 2008, are subject to the underpayment-of-estimated-tax penalty. This bill would specifically provide that no penalties or interest shall be assessed on COD income that results from the discharge of qualified residence indebtedness during the 2007 taxable year.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 1055 As Amended 04/22/2008 Effective for Tax Years 2007 - 2008 Enactment Assumed After 6/30/2008			
	2007-08	2008-09	2009/10
COD Exclusion	-$4,700,000	-$6,900,000	-$1,000,000
Penalty Waiver	< -$150,000[2]	n/a	n/a
Total	-$4,750,000	-$6,900,000	-$1,000,000

[2] For purposes of totaling, less than $150,000 is assumed to be $50,000.

Revenue Discussion

COD Exclusion

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

The revenue impact of this bill would be determined by the amount of qualified principal residence indebtedness discharged and the marginal tax rate of taxpayers otherwise reporting this income.

The revenue loss was estimated as follows. Federal estimates by the Joint Committee on Taxation will be converted to liability (tax) year estimates ($117 million and $200 million for fiscal year (FY) 2008 and 2009, respectively). The federal liability amount was prorated to California using a proration factor of 4.2%. This proration factor was calculated using four factors: (1) the ratio of California foreclosure to foreclosures nationally using data from RealtyTrac (22%); (2) the ratio of median house price in California to median price nationally (145%), calculated using data from National Association of Realtors and California Association of Realtors; (3) the ratio of qualified taxpayers in California to qualified taxpayers nationally (43%), which was calculated based on assumed differences in percentage of foreclosures involving insolvency, non-recourse loans and non-qualified recourse loans; and (4) the California average marginal tax rate as a percent of the federal average marginal tax rate (31%).

The calculation for the 4.2% proration factor is: 0.042 ≈ 0.22 x 1.45 x 0.43 x 0.31

The calculations of the revenue losses *prior to* the February 25, 2008 amendments were:

- 2007 tax year: 4.2% X $117 million ≈ $4.9 million
- 2008 tax year: 4.2% X $200 million ≈ $8.4 million

These estimates were further adjusted to reflect the reduction in the maximum amount of COD excludible, which was reduced from $2 million to $1 million in the February 25, 2008, amendments. We estimated a 5% reduction in the revenue loss due to this reduction.

The *revised revenue loss estimates* are:

- 2007 tax year: 0.95 x $4.9 million ≈ $4.7 million
- 2008 tax year: 0.95 x $8.4 million ≈ $8 million

These taxable year estimates are converted to fiscal year estimates in the table above.

Penalty Waiver

Two estimates are used to arrive at an estimate of the revenue loss due to a waiver of penalty for underpayment of estimated tax for tax year 2007:

- The average tax benefit for each taxpayer - approximately $1,700; and
- The number of taxpayer’s impacted - approximately 3,000.

The penalty rate for underpayment of estimated tax is estimated at 4.3%, and this rate is applied to the average benefit for each taxpayer, resulting in an average penalty of $73 (4.3% of $1,700).

If 50% of taxpayers are affected (assuming 50% file an extension), then the total amount of penalty is approximately $110,000 ($73 X 1,500) for tax year 2007. The penalty waiver would lead to an insignificant loss of revenue (i.e., less than $150,000).

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